

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Speier Analyst: LuAnna Hass Bill Number: SB 285

Related Bills: See Prior Analysis Telephone: 845-7478 Amended Date: April 21, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Relief From Joint And Several Liability On Joint Return

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 19, 2003.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 19, 2003, STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would provide that if an individual receives relief from income tax liabilities under the federal innocent spouse provisions, that individual would also receive relief under the state innocent spouse provisions.

SUMMARY OF AMENDMENTS

The April 21, 2003, amendments resolved several, but not all, of the implementation and policy concerns as discussed in the department's analysis of the bill as introduced February 19, 2003. Specifically, the amendments would allow an individual to receive innocent spouse relief at the state level if the individual was granted innocent spouse relief by the Internal Revenue Service (IRS) and all of the following conditions are satisfied:

- The individual requests state innocent spouse relief.
- The facts and circumstances that apply to the understatement and to the liabilities that are the basis of the state request are the same as the facts and circumstances that apply to the understatement and liabilities for which the individual received federal innocent spouse relief.
- The individual requesting relief provides the Franchise Tax Board (FTB) a copy of the federal determination that granted innocent spouse relief.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Legislative Director
Brian Putler

Date
4/23/03

The provision allowing state relief based on federal relief would not be applicable if the non-requesting spouse on the joint tax return submits specified information to FTB indicating that the individual requesting relief should not be granted state relief similar to the federal relief. The information must be submitted to FTB within 30 days of the non-requesting spouse receiving notice that the other spouse has requested innocent spouse relief. Information indicating relief should not be granted to the requesting spouse is limited to information indicating that:

- the facts and circumstances that apply to the understatement and liabilities of the request are not the same as those that the requesting spouse received relief at the federal level;
- there has been no federal determination granting innocent spouse relief; or
- the federal determination granting relief has been modified, altered, withdrawn, cancelled, or rescinded.

In addition, FTB may not issue a determination regarding innocent spouse relief if the individual demonstrates to FTB that they have requested federal innocent spouse relief for the same facts and circumstances and that the federal determination is not yet final.

As a result of the amendments, the department has identified a new effective and operative date and additional implementation and policy considerations. For convenience, all new and existing concerns are provided below. The remainder of the department's analysis of the bill as introduced February 19, 2003, still applies.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2004, and would apply to any tax liability occurring 1) after the effective date of the act; and 2) before the effective date of the act but are unpaid as of that date. The bill does not address when a liability occurs or the application of the bill to a liability that occurred on the effective date. Amendments 4 and 5 are provided.

POSITION

Pending.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Existing Concerns

- Under current state law, the burden of proof is on the requesting individual to show entitlement to innocent spouse relief. This bill requires relief if the individual has received a favorable determination at the federal level. Although this bill would require the individual to provide the IRS determination letter, this bill does not require the individual to provide FTB with a copy of the supporting documentation that was provided to the IRS, which outlines the basis of the IRS determination. Without the supporting documentation, FTB may be unable to verify the state request is based on the same facts and circumstances as the federal determination. Amendment 1 would allow FTB to request information from the taxpayer in the event the federal determination by itself is unclear regarding the facts and circumstances that led to the federal relief. Any request by FTB for additional information must be reasonable.

- Current state law requires an individual seeking relief under the innocent spouse doctrine of a separate liability election, as discussed under “Federal/State Law,” to request such relief within two years of the date FTB begins collection action with respect to the requesting spouse. Under this bill it is unclear if an individual who receives relief at the federal level through the separate liability election must still meet the two-year deadline for relief at the state level.

New Concern

- This bill would provide an individual relief at the state level based on a federal determination. However, this bill does not provide FTB with the option to make a separate determination in instances where FTB discovers information that the federal determination is erroneous. FTB has access to numerous sources of taxpayer information and utilizes various on-line systems to investigate facts and verify statements made by the non-electing and electing spouses. Sources of information include credit reports, other state agency files (Employment Development Department, Board of Equalization, Secretary of State, Department of Motor Vehicles), various county records, and Lexis/Nexis.
- This bill would prohibit FTB from issuing a determination on a request for innocent spouse relief if the individual requesting the relief notifies FTB that a federal determination is pending. As discussed below under “Program Background,” FTB often completes its determination for innocent spouse relief prior to the federal determination being finalized. Department staff suggests amending this bill to prohibit FTB from denying innocent spouse relief in the event a federal determination is pending, but not prevent FTB from granting such relief while a federal determination is pending. Such an amendment would allow FTB to continue granting innocent spouse relief while a federal determination is pending. Amendment 3 is provided.
- This bill would allow FTB to make an independent determination of relief based on a federal determination only if the non-electing spouse submits specific information to FTB. However, the non-requesting spouse would be unable to submit information indicating that he or she believes the federal determination to be erroneous. The author’s intent is to ease the burden of the requesting individual by allowing relief at the state level without a separate state administrative determination. The non-requesting spouse generally has opportunities under federal law to submit information regarding the validity of the innocent spouse request and to participate in certain administrative proceedings. Amendment 2 is provided to allow the non-requesting spouse to submit information to FTB showing that he or she did not participate in the federal administrative or judicial proceeding that led to the granting of relief at the federal level.

PROGRAM BACKGROUND

Under federal and state income tax law, married individuals may file a single joint return. Individuals who file a joint tax return are each responsible for the accuracy of the return and for the full tax liability for that tax year. These obligations apply regardless of which individual earns the income. The concept of obligating each individual separately for all of the tax liability is called joint and several liability. Joint and several liability can result in inequitable consequences in certain circumstances. Consequently, the federal government and California enacted “innocent spouse” legislation, which may allow a spouse to be relieved of some or all of the responsibility of a joint tax debt.

It is FTB's current practice that a taxpayer requesting innocent spouse relief in California has the right to a determination based on the facts presented to the department, regardless of any relief or denial of relief by the IRS. An individual seeking relief under the California innocent spouse provisions is required to complete a Request for Innocent Spouse Relief election form (federal Form 8857 or FTB form 705) and submit it to FTB's Innocent Spouse Program. During its determination process FTB staff takes into serious consideration whether the IRS granted or denied relief to the requesting spouse. While there is no presumption that FTB should grant the same relief to the requesting taxpayer as the IRS, FTB is also not limited to providing the same relief as the IRS. For example, by making a separate determination, FTB may grant a requesting spouse complete relief where the IRS may have granted partial relief or no relief.

FTB's Innocent Spouse Program (ISP) has increased efficiency and responsiveness by reviewing and updating its policies, procedures, and practices. In September 2001, as a result of then State Controller Kathleen Connell's interest in the program, FTB created the Innocent Spouse Unit comprised of staff whose sole responsibility is to resolve these complex and sensitive requests. Staff also created an ISP web page that is due to debut this year that will allow taxpayers or practitioners to pre-qualify for innocent spouse relief and identify the types of documents that should be submitted with a request for relief.

ARGUMENTS/POLICY CONCERNS

Existing Concerns

As discussed under "State/Federal Law," California law allows avenues for relief that are not available under federal law, including relief from joint and several liability through a divorce court order. It is possible that Spouse A could receive relief through a divorce court order and subsequently Spouse B requests and is granted innocent spouse relief at the federal level. Under this bill, if FTB were unable to make a separate determination, Spouse B would be entitled to state innocent spouse relief. As a result, neither spouse would be liable for the state income tax liability. The ability of Spouse B to gain relief under this bill could also be contrary to the California divorce court order that specified Spouse A was entitled to relief from the joint and several liability and Spouse B was not.

A spouse requesting relief under the state innocent spouse provisions must pay the tax on the income that they earned, managed, or controlled in order to qualify for relief. Often relief is denied in instances of prior tax years where FTB records have been purged and the requesting individual is unable to verify tax was paid on their earned income for the year in question. Under this bill, if the IRS granted relief then FTB would be required to grant similar relief even though the department may be unsure or unable to verify that the requesting spouse has paid the appropriate share of tax.

New Concerns

This bill would allow FTB to make an independent determination of relief based on a federal determination only if the non-electing spouse submits information showing the requesting spouse was not entitled to federal innocent spouse relief or the issues and liabilities were not the same. This would be contrary to the current statutory provision that requires the requesting spouse to prove his or her entitlement to relief. Consequently, the standard for innocent spouse relief in California would be different for applicants with a federal determination than it is for those that request relief without a federal determination.

Requiring the department to grant innocent spouse relief based on a federal determination would prevent the department from making a separate determination based on all the facts and circumstances available to the department. Such a requirement would effectively delegate the State's authority to make independent factual determinations in income tax matters to the IRS, which would be unprecedented.

Generally, FTB processes requests in less time than the IRS. On average, FTB provides a final determination within four to six months. In fiscal year 2001, it took the IRS an average of 12 months to process an innocent spouse case (GAO-02-588). Since the IRS determination is considered in FTB's investigation process, ISP staff inquires about the electing spouse's IRS determination. Often the IRS determination is pending. Depending on the timing of the request for relief, the requesting spouse could receive a determination from FTB prior to receiving a federal determination.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 285
As Amended April 21, 2003

AMENDMENT 1

On page 8, modify line 4 as follows:

of the Internal Revenue Code. If the federal determination does not clearly identify the issues and liabilities for which the individual was granted relief under Section 6015 of the Internal Revenue Code, the Franchise Tax Board may request, from the individual requesting relief, any supporting documentation reasonably necessary to substantiate that the issues and liabilities for which relief is requested under this section are the same as the issues and liabilities for which the individual received relief under Section 6015 of the Internal Revenue Code.

AMENDMENT 2

On page 8, after line 22, insert:

(C) Information indicating that the other individual, as described in the first sentence of this paragraph, did not participate (within the meaning of Section 6015 of the Internal Revenue Code and the regulations thereunder) in the federal administrative or judicial proceeding that resulted in relief under Section 6015 of the Internal Revenue Code.

AMENDMENT 3

On page 8, ~~strikeout~~ lines 31 through 33, inclusive, and insert:

deny relief with respect to that request (in whole or in part) until federal action on the request for relief under Section 6015 of the Internal Revenue Code is final.

AMENDMENT 4

On page 8, line 36, ~~strikeout~~ "occurs" and insert:

becomes final on or

AMENDMENT 5

On page 9, line 1, ~~strikeout~~ "occurred" and insert:

became final